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FOR THE NEW ENGLAND ENERGY INDUSTRY**

**POWER MARKETS IN 2002  
PRESENTED BY:  
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**REMARKS BY  
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**"RESTORING CONFIDENCE IN ENERGY MARKETS"**

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Good evening. I am honored to have the opportunity to address such a diverse and distinguished gathering. You have an excellent program ahead of you. I wish I could stay longer to participate for the full two days.

I have great respect for the progress New England has made in moving to competitive markets for electricity. You have been first movers and are well ahead of most of the nation. Market participants in New England are sophisticated, as are your state regulators and law makers. You have been on the cutting edge, leading the country toward reform and innovation.

In an effort to stay ahead of the FERC, the New England ISO has been in merger negotiations with the New York ISO. I respect those efforts as well, though I realize that some in New England have serious reservation about the wisdom of a merger. I understand that there is a new cost benefit study that questions whether a merger will benefit New England. My general view is that larger RTOs provide a more efficient and reliable trading platform on which wholesale markets can thrive. The Commission has reached no conclusions about this matter, however, and will take all views into account.

For the past two weeks, both California and Washington, DC have been abuzz about the Enron memos. I am sure you know that the FERC has released documents from Enron that revealed a strategy for exploiting California customers based on avarice instead of responsible market participation. In the short time since, there have been almost daily revelations of offensive market behavior by some major market participants.

I am referring to so called round tripping and the like. I am deeply troubled by these revelations, which have eroded market confidence. Thus, my theme for the evening is restoring confidence in electricity markets.

## **I. How we got here**

During my entire tenure as a FERC Commissioner, I have supported the move to a competitive wholesale electricity market because I believed that it would benefit consumers and the nation's economy. When I first came to the Commission in 1993, the transmission grid was largely closed and controlled by entities who also had their own generation to sell. Market participants were trapped by this system. Load serving entities that were not part of a vertically integrated utility had limited choices to meet power needs. For the most part, a customer couldn't buy from the cheapest supplier. The Energy Policy Act of 1992 provided some relief, but it was a cumbersome case by case process that allowed the incumbent transmission provider to litigate the access issue for years.

I championed Order No. 888, a bold step in 1996 to open the grid and provide customer choice. Order No. 888 moved sharply in the right direction, but unfortunately it did not fully eliminate the self dealing incentive inherent in vertical integration. A number of formal and informal complaints alleged that access to the grid continued to be fraught with discrimination. The Commission promulgated its Regional Transmission Organization policy three years ago primarily to solve this fundamental problem. We declared that interstate commerce required the grid to function absolutely without favoritism to particular merchant interests. Independent grid management is essential. RTOs are the nondiscriminatory platform upon which electricity markets should be structured. We are still working on getting RTOs in place in all regions. I might add that New England has always been ahead of the curve on grid regionalization, and I commend the efforts to grow your current ISO into even larger scope.

While we thought we were making strides toward a foundation for competitive markets, and more and more states were moving in that direction on the retail side, the California crisis hit. Wholesale prices soared in late 2000 and early 2001 in California and the entire west. Firms went out of business and thousands lost jobs as a result. The outrage over an out-of-control electricity markets was palpable. For 18 months, this was the number one political issue west of the Rockies. The market finally settled down in spring of 2001 when we imposed a west wide price cap and a must offer condition.

The causes of this crisis are still in debate. Some say it was a genuine supply problem. Others allege that supply was deliberately withheld to drive up prices. Others,

including the FERC, declared that the California market design was dysfunctional. And some say the high natural gas prices drove the electricity market.

There's probably an element of truth in all of those positions. But whatever the cause, the California crisis made a major dent in public confidence in competitive electricity markets. Many states backed away from their restructuring plans. And in my visits overseas since then, from Japan to Argentina to Spain to Holland, the number one energy policy concern is how they can avoid a California crisis in their country.

And now come the revelations of the last few weeks from Enron and other marketers active in the Western markets – revelations of phantom transactions and gaming the market to drive up prices. With the events of the last year, and now the still unfolding confirmations of irresponsible market manipulation, sham transactions and other similar activities, confidence in competitive electricity markets has substantially eroded. That erosion is certainly evident in the political arena. Last week angry U.S. Senators denounced power suppliers for market manipulation and FERC for failing to uncover such activity until now. One Senator announced that he might vote to abolish FERC. The erosion is also evident in financial markets. Several major power suppliers that engaged in round tripping transactions have been hammered by investors who seem to understand that this is not what electricity markets should be about, and key corporate officials are resigning under pressure from concerned boards of directors.

## **II. What needs to be done**

I still believe that competitive electricity markets can work if we are willing to make tough decisions and nurture good markets with appropriate structure and rules. This will take time. But right now, job one is restoring consumer and political confidence in the markets and in our ability to oversee those markets. I call on all market participants to help the FERC restore that confidence. Do your part by engaging in only ethical business practices. Now is not the time for Fat Boy and Death Star strategies. Now is not the time for phantom round tripping transactions. And now is not the time to jeopardize grid reliability and regard it as nothing more than a public relations problem. Members of Congress, policy makers at the state level, and consumers in general want to know whether this kind of behavior is what markets are all about. If it is, they will want nothing to do with electricity markets.

### **A. Stop the funny business**

My message to all market participants is this: stop the funny business. Behave responsibly and ethically. We need all market participants to act in ways that help restore public confidence. At this point in time, the FERC simply won't tolerate anything less.

## **B. Get to the bottom of the Western market crisis**

Beyond that, there are a number of things the FERC can do to restore confidence and get us back on track. First, the Commission staff must complete its ongoing investigation into what went on in the Western markets during 2000 and 2001. Staff must leave no stone unturned. It must be crystal clear to everyone that this agency truly wants to get to the bottom of this mess. We must learn exactly what occurred so we know how to prevent it in the future.

## **C. Establish good markets**

Second, we need to get on with facilitating markets that actually work for customers. The transition to competitive wholesale markets in many regions drags on, with no end in sight. This uncertainty is a cause of concern.

The Commission's Standard Market Design initiative has the promise of promoting good markets. The fundamental feature of the standard market design is a real-time or spot market with a bid-based, security constrained economic dispatch that uses locational marginal prices, or LMP. The security constrained feature ensures that only transactions that are physically feasible may be scheduled on the grid. And LMP provides efficient price signals that reflect the time and locational value of electricity. Another important feature is a bid-based, day ahead market. This market provides a day ahead schedule for transmission and energy and results in financially binding settlements. Again, all resources, including demand, may participate. This market provides market participants with time to adjust their supply and consumption decisions based on price signals, and thus enhances efficiency and market power mitigation.

Our standard market design embraces an active demand response in the market. This is a critical feature. Demand side solutions will be considered on par with transmission and generation solutions. This is important for a number of reasons. First, demand responsiveness can be an important resource for ensuring adequacy and reliability. Second, demand responsiveness can be a key factor in congestion management. Reducing load frees up transmission capacity. And third, demand responsiveness is an important tool for mitigating market power.

The standard market design will also facilitate the development of distributed generation resources. These resources can substitute for large transmission or generation

investments, improve reliability, reduce pollution, improve customer choice, and can help to limit market power. The standard market design will help distributed generation development by providing truly non-discriminatory access to the grid through an RTO. DG is also helped by an LMP price that shows the true cost of energy in congested areas. And DG units can fetch the congestion price if they sell into the grid.

#### **D. Market monitoring and mitigation**

We also need good, aggressive market monitoring to help restore confidence in electricity markets. We have to stay one step ahead of the market participants. This will require team work between the Commission's new market oversight office headed by Bill Hederman and the troops on the ground – the independent market monitors that our standard market design requires. That team must be given the resources and the authority to do their jobs in a thorough and professional manner that inspires confidence.

We also need effective up-front market mitigation measures if we are to restore confidence in the market. As we have seen, electricity prices can soar quickly. The market rules have to clearly define mitigation thresholds and put all participants on notice that anomalous behavior will not be allowed to run up prices.

#### **E. Infrastructure and Interconnection**

There are two other points I want to make. First, the Commission is doing all it can to shine a spotlight on infrastructure issues. Transmission investment in particular has not kept pace with the needs of the market. Part of the problem is regulatory uncertainty. The sooner the market structure and jurisdictional issues are settled, the better. Also, the Commission is allowing more generous returns for transmission, in the 11-13% range. Perhaps this will spur investment. The Commission has also authorized incentive rate treatment for several new merchant transmission proposals, many of which are in the northeast. I know states have a difficult siting challenge. I don't envy them when making these tough decisions. Yet, there are transmission investments that must be made and must be sited for competitive wholesale markets to thrive and benefit consumers.

My last point relates to generation interconnection. At my urging, over the past two years, the Commission had begun a rulemaking to standardize the processes and agreements of interconnection. We want to streamline the process and eliminate legerdemain. Interconnection decisions should be based on economics rather than on which utility or region has the easiest process. I am very proud of this initiative and believe it will facilitate good markets and a more efficient hooking up to the grid.

### **III. Conclusion**

Now, New England has been working toward many of these measures for some time now. Non discriminatory transmission access is already a reality in New England, as is a more standardized interconnection process. New England has an active market monitoring unit. The New England state commissions, through NECPUC, have been very active in shaping ISO and RTO policy. You are moving already toward the standard market design. I commend all of you. The movement to competitive wholesale markets in New England has been underway in a sophisticated way for years.

Let us redouble our efforts to achieve consumer benefits. Help us restore nationwide confidence in a market-based approach for electricity. The nation for some time has looked to the Northeast for innovation and sound electricity policy. Let's make this work for consumers. The American people deserve electricity markets they can be proud of. Electricity is surely too important to the social, economic, public health and safety fabric of our society to settle for anything less.

Thank you.